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FINANCIAL APEX ORGANIZATIONS: EXPERIENCES FROM MEXICO

by

Mario Villalpando-Benitez

and

Claudio Gonzalez-Vega

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Rural Finance Program
Department of Agricultural, Environmental, and Development Economics
The Ohio State University
2120 Fyffe Road
Columbus, Ohio 43210-1099
rurfin@postbox.acs.ohio-state.edu

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Financial Apex Organizations: Experiences From Mexico[1]

Mario Villalpando-Benitez and Claudio Gonzalez-Vega[2]

I. Introduction

The Mexican case is rich in experiences about the effects of government intervention in financial markets. The Mexican Federal Government, in particular, has made extensive use of a number of instruments to supply targeted and subsidized credit for economic activities labeled as "of national interest."

The history of government intervention in financial markets begins right after the end of the Mexican Revolution. In the early 1930s, the Government began to create state-owned national banks as a means of promoting the development of specific sectors of economic activity. In less than ten years, seven state-owned banks were established. Among them, *Nacional Financiera* (NAFIN) and *Banco Nacional de Comercio Exterior* (BANCOMEXT) are still in operation, and their importance has not diminished over the years.

During the so-called *Stabilizing Development Period* (from the early 1940s through the late 1960s), the menu of government instruments to spur economic development through the financial system was extended further to include reserve requirements on bank deposits, ceilings on the interest rates charged on specific bank loans, and the creation of a broad set of trust or credit guarantee funds for the promotion of particular types of economic activities (*Fondos*).

In particular, reserve requirements were used by the Mexican authorities less as instruments of monetary policy and more as planning tools to influence the allocation of credit. Thus, reserve requirements were lowered when the funds mobilized by the banks were channeled to priority activities. In turn, the apex organizations known as *Fondos* were established to promote specific projects and/or particular sectors and clienteles. In contrast to the activities of the state-owned banks, the operations of the *Fondos* have taken place at the second-tier level through the discount of private-bank loans (Vásquez, 1993).

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2 The authors are, respectively, Graduate Research Associate and Professor in the Department of Agricultural, Environmental and Development Economics at The Ohio State University. Gonzalez-Vega is Director of the Rural Finance Program.

Promotion of the microenterprise sector took the back seat in the development of the Mexican banking system. Emphasis was placed on employment-creation, so most directed credit programs attempted to spur the growth of medium-size and large firms.

As an exception, for over thirty years, the Guarantee Fund for Small and Medium Industry (*Fondo de Garantía para la Pequeña y Mediana Industria* - FOGAIN), a government-established financial apex, directed some credit toward small and microenterprises. The effects of FOGAIN on these sectors, however, seem to have been marginal. The aggregate data on the operations of this apex mechanism show a bias in favor of medium-size businesses operating in the manufacturing sector (Ramírez, 1985).

Recently, nevertheless, the microenterprise sector has been accorded a special place in the plans and policies of the Mexican Government. Two factors explain this recent behavior. First, the potential of microenterprises in creating employment opportunities has been recognized. A number of sample surveys have shown that about two-thirds of total employment in Mexico are generated by microenterprises (Ruiz, 1995).

Second, the average funding requirements of a firm in the microenterprise sector are typically lower than those of a large firm. This is particularly important, given the current situation of public finances in Mexico. The dearth of fiscal resources has compelled the Government to close down some promotion and guarantee funds and to begin a reorganization of the development banking system. When the availability of resources is sharply limited, a larger number of firms can be reached if they demand smaller loans.

The new emphasis placed by the authorities on the microenterprise sector has led to the design of two programs targeted to promoting it. One of them consists of an apex mechanism to be run by NAFIN. The main objective of this mechanism will be to strengthen non-government (NGO) microfinance organizations. An initial pilot program will be implemented in early 1998. This program will be described below.

The second program to promote the microenterprise sector is being structured by the Central Bank (*Banco de México*) and by World Bank officials. In contrast to the NAFIN apex, this program will have as its main objective to induce private banks to establish new branches in small towns. This program will also be described below.

The rest of this paper is organized as follows. The next section describes the historical evolution of the Mexican development banking system. This section contains, as well, a brief review of the main justifications for government intervention in the allocation of credit offered by the authorities. Section III provides a profiles of existing microfinance organizations. The main objective of this section is to identify the size of the microfinance market in Mexico. Section IV describes some second-tier financial organizations that have operated in Mexico, and it derives lessons from their experience. Section V discusses the two new microfinance programs sponsored by the Government. Some conclusions complete the paper.

II. The Mexican Development Banking System

The consolidation of the current development banking system in Mexico can be dated to the 1950s and 1960s. At that time, the financial authorities argued a number of reasons to support the creation of new state-owned development banks and of several promotion or guarantee funds and the design of mechanisms to allocate credit to areas labeled as critical for economic development, such as agriculture and manufacturing. Selective credit instruments and loan interest-rate controls were adopted as key mechanisms to achieve these goals.

Justifications for intervention in financial markets

Two main arguments have been used in Mexico to justify government intervention in the financial sector.[3] First, policymakers have highlighted the dearth of information among private banks about non-commercial activities. Policymakers believe that private banks have been reluctant to allocate enough credit to agriculture and industry because bank managers have wrong perceptions about levels of risk in these sectors of economic activity. These perceptions may in part reflect that bankers tend to evaluate potential borrowers on a short-term basis while most agricultural and industrial projects are profitable only in the long-run.

According to this reasoning, the state has an important role in addressing the myopic behavior of private banks. On the one hand, there is a direct role for government through the operation of state-owned banks. On the other hand, the risks associated with loans for development projects can be indirectly shared with the private banks through the operation of second-tier organizations such as guarantee funds (*Fondos*).

Presumably, the availability of credit for new firms in agriculture and industry generates positive externalities for the overall economic system. This has been the second justification in favor of the creation of the development banking system. Solís (1961), who is one of the major intellectual forces behind the *Stabilizing Development Period* (1940-1960), claims that, to be able to promote economic development, the state has to share the start-up risks of new manufacturing and agricultural firms. This author argues that after an initial period, the new firms will generate sufficient expected profits to compensate for the subsidy.

Based on these theoretical arguments and frequently based on political and rent-seeking pressures, the Mexican authorities have established an extensive development banking system.

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[3] These arguments are presented here only to describe the ideological environment that led to the creation of financial apex organizations. It is not the objective of this paper to evaluate the validity of these arguments.

Structure of the development banking system

The development banking system of Mexico has been structured at three levels. At the first level, the state-owned development banks offer access to credit to selected firms for their initial funding and for their working capital. The leading orientation of the development banking system has been to support the expansion of the industrial sector. Currently, there are seven state-owned national banks. The most important are the *Nacional Financiera (NAFIN), Banco Nacional de Comercio Exterior (BANCOMEXT), Banco Nacional de Crédito Rural (BANRURAL), and Banco Nacional de Obras y Servicios Públicos (BANOBRAS).*

At the second level, before 1988 the Central Bank required minimum legal reserve requirements on the total liabilities of the private banks, and it established rules on the interest rates to be charged by the banks on loans to agriculture, manufacturing, and foreign trade activities. These tools of financial repression were eliminated with the liberalizing financial reforms of the late 1980s.

At the third level, 13 promotion or guarantee funds operate as second-tier apex organizations to discount bank loans for special projects and/or specific clienteles. The most important promotion funds are the apex mechanisms related to the promotion of agriculture (FIRA), the promotion of exports of manufactured goods (FOMEX), the financing of popular housing (FOVI), and the promotion of the small and medium-size business sector (NAFIN-FOGAIN).

Deep structural changes took place in the Mexican economy during the 1980s. The public sector was downsized, most of the state-owned enterprises were sold to the private sector, and government intervention in the economy was limited to areas identified with the national interest (Gil Díaz, 1992). These measures were a response to the scarcity of fiscal funds, a result of the costs of servicing the large foreign public debt, which had reached the upper limit of the payment capacity of the Mexican Government. Furthermore, since 1985 the economy has been increasingly opened to international competition. Most of the earlier quantitative controls on trade have been replaced by comparatively low import tariffs, and major laws have been modified to allow the participation of foreign direct investment in a larger number of sectors of economic activity (Noyola, 1993).

The scarcity of public funds and the reorganization of the Federal Government have affected both the size and the operation of the development banking system. The scarcity of fiscal funds has constrained the outreach of the state-owned banks and of the promotion funds. For instance, in the two years following the critical period around 1982, the resources available to finance agriculture fell almost by 30 percent.[4] To face this situation, the development banking system was reorganized. Some of the major changes introduced have included a merging of all the promotion funds related to the industrial sector into one and the liquidation of several other funds.

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[4] In 1982, the Mexican public finances were in a critical situation. The available fiscal funds were insufficient to cover the service of the public debt, and the Finance Minister requested a debt rescheduling from the main foreign creditors.

Financial apex organizations have played an important role in the evolution of the Mexican development banking system. This role continued to be important during the De la Madrid (1982-1988), Salinas (1988-1994), and Zedillo (1994-2000) administrations, when government intervention in the financial system has been redefined. Indeed, apex organizations have been chosen as the main instruments of public action in credit markets, while the retailing role of the state-owned banks has been minimized.

For this purpose, most of the earlier promotion funds have been plugged into the programs of the state-owned banks, whose main operations are now expected to take place at the wholesale level. The apex organizations for industry, for instance, have been appended to NAFIN. At the same time, the direct retailing participation of the state-owned banks has been restricted to cases where the private commercial banks are still reluctant to step in. In this new environment, low-income peasants and microentrepreneurs have been included among the main target groups of the development banking system.

III. The Microfinance Sector

For a long time, the microenterprise sector had been neglected by the Mexican formal financial system. A number of factors explain this situation. First, most small and microenterprises have been unable to fulfill the eligibility criteria for a bank loan. Microenterprises, in particular, have been unable to offer the collateral required by formal credit contracts.

Second, the transaction costs incurred both by the bank and by the potential borrower in the process of determination of the borrower's creditworthiness are extremely high compared to the size of the loan. This makes loans unprofitable for the bank and expensive for the borrower.

The small and microenterprise sectors had been relegated, as well, to a second place in the programs of the state-owned development banking system. The priority in these programs had until recently been the promotion of large enterprises in the industrial sector. For this reason, small and microenterprises were unable to access the subsidized credit offered by these government programs.

Both the reluctance of private banks and the low level of interest of the development banks opened the opportunity for some private financial organizations to respond in part to the demands of the small and microenterprise sector. This semi-formal microfinance sector is composed of credit cooperatives, savings and loan societies, credit unions, solidarity credit cooperatives, and some non-government organizations and charity organizations.

The study of the Mexican microfinance sector is difficult due to a dearth of information. There is not, for example, a comprehensive inventory of microfinance organizations in the country. The information available, however, reveals an unfavorable situation for the sector.

Credit cooperative organizations

It is estimated that there are at least 300 credit cooperatives (*cajas or cooperativas de ahorro y crédito*) in Mexico, a comparatively small number for such a large country. *Caja Popular Mexicana*, which is the largest conglomerate of this kind of organizations, includes almost one-half of the total (120 cooperatives). This confederation associates over 300,000 members. The principal areas of influence of these credit cooperatives are the central and southeastern regions of the country. There are, as well, a number of independent cooperative organizations dispersed across the country. It is difficult to figure out both the exact number of these cooperatives and their importance, but it is known that most of them have a short life (Secretaría de Hacienda y Crédito Público, 1993).

A common set of principles governs the operations of cooperative organizations. The most important of these principles are:

(a) free membership,
(b) one-person, one-vote,
(c) no returns on capital, and
(d) the use of profits for social purposes.

Chaves (1994) has shown that these principles impose strong constraints on the potential growth capacity of cooperatives. Free membership, together with insufficient portfolio diversification, for instance, introduce uncertainty in the organization, so that any moderate or sharp economic fluctuation in the region can lead to a massive exodus of members. The second principle, one-person, one-vote, induces internal control problems. The collective action of a majority of members can bias the allocation of credit at favorable terms toward specific groups of borrowers in detriment of depositors.

The third and fourth cooperative principles, no returns on capital and the use of profits for social purposes, also constrain the potential growth of these organizations. In particular, the board of directors and/or managers have no incentives to pursue expansion plans because the profit motive is absent. Furthermore, the requirement to use yearly profits in social projects may lead to the opportunistic behavior of managers. In effect, managers are likely to spend these profits in projects related to their personal satisfaction.

The behavior of the Mexican credit cooperatives fits theoretical predictions about these financial organizations. Cooperatives members of the *Caja Popular Mexicana* (CPM) can be chosen as representative examples of the overall movement. Indeed, threats to the stability of the CPM have long been a main concern for its managers. For example, the membership of the largest federation among the members of CPM (COECILLO) shows an unstable behavior. In only one year (1993), changes in the membership of the credit cooperatives in this federation varied within an ample range: from -15 to 33 percent (Caja Popular Mexicana, 1993).

A high level of non-performing loans is another key concern regarding the CPM. In 1993, almost 20 percent of COECILLO's members defaulted in the payment of their loans and were ousted from the cooperatives. Even more, arrears constituted more than 20 percent of the total loan portfolio.

The absence of a formal framework (legal status) for credit cooperatives is a factor that complicates even more the situation of these organizations. In Mexico, the legal framework only allows the operation of consumption or production cooperatives but not of financial cooperatives. Savings and loan cooperatives have bypassed this legal vacuum by adopting the status of civil organizations. This solution, however, has raised serious restrictions on the development of credit cooperative organizations. One the one hand, these organizations have not been able to extend their financial services beyond loans tied to member shares and savings deposits. They have not mobilized deposits from the public. On the other hand, these financial transactions are based only on a good-faith agreement between the member and the board of directors or the cooperative's manager.

The lack of an appropriate legal status introduces a critical moral hazard problem in the relationship between the members and the managers of a credit cooperative. To allow the completion of deposit and loan transactions and to prosecute fraudulent acts, the managers are endowed with the legal ownership of the assets of the association. Quite a few crooks have taken advantage of this opportunity to create phony credit cooperatives and then run away with the deposits.

The credit cooperatives, mainly the *Caja Popular Mexicana*, have requested the financial authorities that their organizations be included in the formal financial system. The authorities have rejected this petition arguing that the stability of the aggregate financial system can be negatively affected by the inclusion of credit cooperatives in the set of regulated financial institutions. To justify their decision, the authorities point to the erratic behavior of these organizations.

Moreover, the sustainability of the credit cooperatives seems to be directly linked to the good faith of the board of directors and managers. This means that most of the credit cooperatives would require a close and detailed monitoring of their operations by a regulatory board. The prudential regulation of credit cooperatives, however, is even harder than for banks due to the large number of small organizations dispersed along the country and the broader set of risks that threaten their sustainability.

Savings and loan societies

In 1993, the class of savings and loan societies (*sociedad de ahorro y préstamo* or SAP) was added to the group of formal financial institutions. According to the decree, the structure of a SAP corresponds closely to the description of a credit cooperative. A SAP is defined as a non-profit organization with open membership. Its functions are constrained to managing savings deposits and loans to its members. The cooperative principles of one-person, one-vote and the use of any economic surplus to accumulate capital or to finance community projects are also effective for the

SAPs. The SAPs are thus vulnerable to the same threats from weak property and governance structures as credit cooperatives are.

The first SAP to be authorized was the *Caja Mexicana de Fomento* (CANAFO). The outreach of CANAFO seems impressive. In the first two years, its membership reached more than 70,000 members in 98 branches (Boutielle, 1993). The demand for authorization by many other financial organizations that want to become SAPs has been strong. During the year when the decree was issued, more than 120 organizations requested the SAP charter.

The process of authorization has been, however, slow and difficult for the large number of financial organizations that are looking forward to become SAPs. The weak financial situation of most of them has been the principal obstacle. Less than one-fifth of the credit cooperatives that constitute *Caja Popular Mexicana*, for instance, fulfill the minimum standard requirements of a healthy financial institution and therefore cannot be converted into SAPs (Caja Popular Mexicana, 1993). Table 1 shows selected data on the credit cooperatives that had requested a SAP charter through 1995.

Credit unions

The credit union charter (*unión de crédito*) has formally existed since 1932. The original purpose of this type of financial organization was to form syndicates of individual producers and/or small firms to reap the benefits of subsidized credit. The behavior of the credit union movement has been erratic. Due to a high degree of opportunistic behavior, credit unions are usually short-lived. It is common practice of credit union members to request long-term loans from state-owned banks and then fall in default in their obligations.

The incentive for a credit union member to get behind in his loan repayment obligations rests on two factors. First, credit unions lack a true owner, and the obligations of their members are restricted to their initial contributions, which are an insignificant proportion of their outstanding loans. Second, the policy followed by the financial authorities has been to forgive the overdue debts of credit unions.

Thus, in practice, rent-seeking credit unions have been an instrument of pressure groups to access the benefits of cheap or even free fiscal resources. Credit has been viewed by government officials just as another subsidy instrument, not as a financial contractual relationship.

The 1990-94 period was a golden age for the credit union movement. The administration in power decided to substantially increase the amount of fiscal resources available to credit unions. This decision was partially founded on the assumption that credit union members typically are entrepreneurs relegated from access to the formal financial system. As Table 2 shows, during this period NAFIN increased the amount of resources disbursed through credit unions by more than 60 times. The growth of this type of financial intermediaries can be described as explosive. In six years, the number of credit unions funded by NAFIN increased six-fold.

Table 1. Credit cooperatives that had requested a SAP charter by 1995 (units and thousands of U.S. dollars*)

State	Members	Number of cooperatives	Assets	Loans	Savings deposits
Baja California	160	1	646	606	598
Colima	7,575	5	3,766	2,978	2,869
Chihuahua	60,609	6	12,479	7,224	9,122
Mexico City	11,110	7	9,953	3,633	3,002
Durango	15,884	2	14,983	12,421	13,445
Guanajuato	18,373	8	9,804	7,068	10,400
Hidalgo	20,573	3	21,364	17,324	16,933
Jalisco	123,930	31	87,718	53,445	50,713
State of Mexico	5,075	5	105,029	76,211	105,909
Michoacan	2,573	2	1,050	985	943
Nayarit	1,985	1	1,026	173	782
Nuevo Leon	1,847	1	616	446	417
Oaxaca	2,919	1	1,526	1,282	1,309
Puebla	1,259	1	931	746	647
Queretaro	237,738	25	379,087	322,052	354,231
San Luis	391,624	13	262,640	219,649	199,808
Sinaloa	8,677	5	4,652	3,492	3,200
Sonora	1,000	1	441	0	0
Tabasco	1,500	1	1,548	1,366	854
Tamaulipas	4,502	1	311	183	231
Veracruz	3,084	1	2,263	1,843	1,638
Yucatan	24,565	5	15,063	12,015	10,513
Zacatecas	4,474	2	4,234	1,080	3,263
Total	951,036	128	941,130	746,222	790,827

* Exchange rate: 3.30 pesos per U.S. dollar.
Source: Secretaría de Hacienda y Crédito Público.

The political decision to increase the number of credit unions, combined with the inability of the regulatory entities to supervise each and all organizations, has created numerous headaches for the financial authorities. Several credit unions have been intervened by the National Banking Commission (*Comisión Nacional Bancaria*) due to non-performing portfolios. Even more, several cases of fraud have been brought to public attention, such as the case of the *Unión de Crédito Valle de México*. Currently, a trial is in process for the fraud presumably committed by the managers of UNICREVA. The amount of the fraud is more than US$240 million.

Table 2. NAFIN: Affiliated credit unions and amount disbursed through credit unions, 1989-1995 (number of units and thousands of Pesos)

Year	Number of Credit Unions	Amount disbursed through credit unions
1989	40	43,600
1990	75	127,219
1991	121	745,425
1992	172	2,181,227
1993	237	5,675,613
1994	279	8,128,587
1995	274	n.a.

n.a. Not Available.
Source: NAFIN.

Among the universe of credit unions, only the members of the Mexican Association of Credit Unions (AMUCSS) can be considered as microfinance organizations. The AMUCSS membership is composed of low-income peasants, and most of them can be considered as low-productivity entrepreneurs (Mansell, 1995).

The sources of funds for AMUCSS are varied. They include two state-owned banks and one promotion fund, namely BANRURAL, NAFIN, and FIRA. Other sources of funds are the Ford Foundation and the Interamerican Foundation. The initial capital and the growth of the social capital of the credit unions affiliated with AMUCSS come from the issuing of participation shares in small par values.

The financial health of the AMUCSS affiliates is poor. As Table 3 shows, the non-performing loan portfolio varies along a range of 11 to 87 percent of the total portfolio. The average loan portfolio in arrears is 19 percent. These figures indicate that credit unions are an extremely inefficient instrument to disburse funds to the microenterprise sector.

Solidaridad credit cooperatives

The national anti-poverty program (*Programa Nacional de Solidaridad*) of the Salinas administration had a deep impact on the Mexican development strategy. Initially, *Solidaridad* was designed as a way to cope with the adverse effects of export-led development on workers located in unproductive sectors of the economy. For this purpose, most of the formerly independent social programs, which were dispersed among several government bureaus, were merged into *Solidaridad.* The Ministry of Social Development was created to manage these resources. The current Zedillo administration has kept the main structure of *Solidaridad.* It has renamed, however, some of its main components, and the word *Solidaridad* has been deleted from the government's vocabulary.

Table 3. AMUCSS credit unions: Selected financial indicators, 1989-1995. (Accumulated amounts in pesos)

State	Total disbursements	Total Repayments	Repayment Rate[a]	Loans not due	Loans overdue	Arrears rate[b]
Sonora	447,756	338,658	75.6	44,085	65,013	14.5
Sinaloa	14,353	11,557	80.5	18	2,778	19.4
Chihuahua	24,687	15,582	63.1	3,584	5,521	22.4
Durango	15,627	10,297	65.9	2,364	2,966	19.0
Zacatecas	147,377	53,900	36.6	45,270	48,207	32.7
Nayarit	16,164	14,098	87.2	2,025	41	0.3
Jalisco	11,781	7,930	67.3	3,743	108	0.9
Guanajuato	495	209	42.2	0	286	57.8
México	17,050	9,756	57.2	1,244	6,050	35.5
Hidalgo	4,839	2,534	52.4	1,982	323	6.7
Puebla	101,478	32,208	31.7	39,398	29,872	29.4
Morelos	13,017	7,939	61.0	2,215	2,863	22.0
Guerrero	10,065	5,793	57.6	975	3,297	32.8
Veracruz	63,422	43,798	69.1	10,756	11,658	18.4
Oaxaca	32,499	3,560	11.0	28,939	0	0.0
Chiapas	13,536	6,451	47.7	5,333	1,752	n.a.
Total	934,146	564,270	60.4	191,931	180,735	19.4

a Repayments as a percentage of total disbursements.
b Arrears as a percentage of total accumulated loan portfolio.
Source: AMUCSS, 1997.

The *Solidaridad* credit cooperatives are one of the components of the financial side of the Solidarity Program. The initial capital of these cooperatives came from the loan repayments of the "credit on one's word" program (*crédito a la palabra*). As its name indicates, the credit-on-one's-word program was designed to offer loans to the poorest peasants, who harvest beans and corn in low-productivity lands, without collateral requirements.

Among the functions of the Solidarity Enterprises National Fund, a decentralized government agency, are to promote, monitor, and supervise the behavior of the *Solidaridad* cooperatives. The Canadian cooperative organization *Développement International Desjardins* has provided the technological design of this type of cooperative. The *Solidaridad* cooperative is governed by the general assembly and a board of directors. The policies related to savings and loan activities are set by the general assembly. Loan and deposit interest rates, for instance, are set by majority vote in the general assembly.

Table 4 presents selected data on the *Solidaridad* credit cooperatives. Although aggregate financial data do not capture the heterogeneity of the performance of these cooperatives, the figures about arrears and liquidity may indicate future problems. In particular, the loan portfolio in arrears increased from 4.4 percent in 1994 to 17.4 percent in 1996. These are threatening signs but not unexpected results given the political origin of the system.

Table 4. Solidaridad credit cooperatives: selected financial indicators (percentages)

Financial ratios	Dec. '94	Dec. '95	Dec. '96
Liquidity/Assets	47.1	45. 8	43.2
Short-run liquidity[a]	19.6	13.1	7.5
Savings/Assets	4.7	6.1	10.8
Loans/Assets	46.9	43.1	42.8
Arrears	4.4	12.8	17.4
Capital/Assets	91.2	85.7	81.4
Leverage[b]	0.1	0.2	0.2
Return on Capital	6.3	19.0	17.0
Net Income/Assets	5.7	16.3	13.8

a Reserves/Short-run debt.
b Liabilities/Capital.
Source: FONAES, 1996.

Although it may be too early for a precise evaluation of the *Solidaridad* cooperatives, it is appropriate to recognize a number of issues. First, the cooperative structure has numerous flaws which limit its usefulness as an efficient financial institution. Second, government-led programs usually introduce rent-seeking behavior by the clientele of financial organizations which threatens loan repayment. Finally, political intervention in general introduces severe doubts regarding the sustainability of financial organizations. The enduring of the Solidarity Program, for example, has relied on the mood of the politicians in power.

Recent microfinance innovations

Some commercial banks and retailing chain stores have recently entered the microfinance business. Two factors explain this behavior. First, the recent openness with respect to the supply of financial services by foreign intermediaries has created a new competitive environment in the banking system. The entry of both foreign banks and brokerage houses in the market constitutes a threat to the market share of Mexican banks, particularly for the banks specialized in the attention of corporate clients. Furthermore, some foreign banks have made attempts to attract the savings of middle-income households. For this purpose, several foreign banks have acquired Mexican banks so that they can take advantage of the branching infrastructure of these banks.

Several medium-size Mexican banks have faced this new competitive environment by downscaling their services to reach both a popular clientele and microenterprises. Two examples are BITAL and BANCRECER. The latter has been a pioneer in the strategy of setting up numerous small branches. At the beginning, BANCRECER constrained the expansion of this network to cities located in the central region of the country. Its main focus of attention was to respond to the financial demands of small shoemakers in León, Guanajuato. This task has been approached by opening branches inside the markets where the shoemakers and their suppliers engage in their transactions. The BANCRECER branches are usually staffed by one or two tellers, with a front desk and a pair of waiting chairs.[5]

BITAL is another remarkable example of the emerging microfinance sector in Mexico. BITAL has followed the strategy of adapting traditional savings schemes to a formal setting. The *tanda*, one of the Mexican terms for rotating savings and credit association (ROSCA), is one of the products that BITAL has offered to the low-income population. BITAL has introduced, moreover, some improvements in this product. In contrast to the informal variety, the BITAL *tanda* allows the customer to set the amount to be deposited each month and the term to maturity of the contract. The minimum deposit and term are US$ 12 and six months, respectively. Another characteristic of this savings formula is that the bank pays an attractive interest rate on the deposits. The *tanda* members are also included in lotteries where they can win from 2 to 20 times their monthly deposit.

BITAL provides the depositor with life insurance and with the chance to get a personal loan. To be eligible for a personal loan, the client is required to have the direct deposit of his/her monthly wages. At the beginning, the amount of the loan is one-and-a-half times the individual's monthly wage. The term of the loan is six months, and a nominal monthly interest rate of 6 percent is charged.[6]

The considerable amount of money transfers of immigrant Mexican workers is the second factor that explains the recent interest in microfinance. Several commercial banks, retailing chain stores, and postal and telegraph companies have made efforts to attract a share of the six billion U.S. dollars that Mexican workers send their families each year (*BusinessWeek*, 5/12/97).

So far, the service provided by banks has been limited to just the transfer of funds mainly from the U.S. to Mexico. Three of the largest Mexican banks (BANAMEX, BANCOMER, and SERFIN) have signed contracts with U.S. telegraph companies, such as Western Union and

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5 This development has paralleled the operation of small bank branches in supermarkets in the United States. Moreover, BANCRECER has transferred this technology to its subsidiaries in other countries such as Costa Rica.

6 The average monthly inflation rate was 1.3 percent in 1997. Thus, BITAL's loan interest rate was equal to 4.7 percent per month.

MoneyGram Payment Systems, to make electronic transfers of money. The cost of the transfer, however, is still considerable.

Non-financial intermediaries, such as Elektra (an appliance retail chain store), have also offered the service of transfer of funds. Elektra, in particular, has had an important impact in low-income areas, small cities, and rural areas. This is due to the large number of chain stores located across the country.

The recent emergence of the microfinance sector in Mexico seems to be the result of an upward shift of the demand for financial services. In response, financial intermediaries not only have increased the supply of traditional services, but they have also adopted technological improvements to face the higher demand. All of these innovations and adaptations have emerged with no intervention of the state and no role for an apex organization.

The government, however, has not been outside of the new microfinance scenario. Since 1988, the National Savings Bond Program (*Patronato del Ahorro Nacional*) has set up branches in the postal offices located mainly in rural zones. Government officials have extolled this program arguing its remarkable savings mobilization success (Werner, 1997).

Altruistic organizations

Many NGOs were born after the earthquake that shattered Mexico City in 1985. Some of these NGOs were created to meet the immediate needs of the affected population, such as the provision of shelter, food, and health care. Other NGOs were established to help address the negative effects of the earthquake on the level of economic activity. Some NGOs, for instance, started programs to generate employment and offer small loans to the population in the affected areas. This active role of NGOs in the promotion of economic activities has been remarkable because before this natural disaster their functions were constrained to charity.

The birth of a handful of microfinance NGOs can also be dated back to 1985. Among them, *Emprendedores*, CAME, and *Compartamos* stand out because of their comparative financial success. Initially, these organizations were programs of altruistic institutions designed to transfer financial resources to microentrepreneurs. Their initial sources of funds were grants by some large corporations. Later on, due to the financial stability and outreach of these programs, some international donors (World Bank, IDB, and Ford Foundation, among others) granted them substantial amounts of funds so they could increase their operations.

The target population of *Emprendedores* is found in some of the poorest areas of Mexico City. The main objective of this NGO is to create and consolidate jobs by means of individual loans to microentrepreneurs. Loans are granted on the basis of creditworthiness. The potential borrowers must operate a stable business. Also, either they must have the endorsement of one or more members of their community who certify that they are good borrowers or they must provide collateral to back the loan. *Emprendedores* charges loan interest rates that reflect the cost of the funds. An additional requirement is that the wealth of the potential borrower must be less than 15 yearly minimum wages (around US$1,300, given an exchange rate of 8.30 pesos per US dollar).

Emprendedores seems to have reached a small but stable level of operations. In 1996 and 1997, for instance, the total number of loans granted was 888 and 809, respectively. This organization in 1997 reached just 64 more borrowers than the 384 borrowers reached in 1996. The ratio of the non-performing loan portfolio of *Emprendedores* is higher than for *Compartamos* and CAME. Non-performing loans were 9.5 and 5.1 percent of the total portfolio in 1996 and 1997, respectively. Despite some attractive features, therefore, this NGO contributes little to the expansion of microfinance in Mexico. It is an example of numerous other NGOs with extremely low outreach and questionable sustainability.

CAME is another apparently successful microfinance NGO. It was created to reach microentrepreneurs in the Chalco area, the poorest of the suburbs of Mexico City. Although CAME was originally a program of *Emprendedores*, it is different in several aspects; in particular, CAME has implemented a group-lending technology. It gives an initial loan to a group of 15 individuals who offer joint liability for all other group members. The size of loan increases as the group pays previous loans. As in *Emprendedores*, loan interest rates are high enough to cover the cost of funds plus administrative expenses. In addition, CAME requires the group to accumulate savings equivalent at least to one-third of outstanding loans. This further raises the effective interest rates charged.

Table 5 shows selected indicators for CAME. From 1993 to 1997, the number of borrowers increased almost seven times. Both the loan and savings per member are increasing at a similar pace. For this reason, the ratio of savings to outstanding loans has been kept around 66 percent, which is higher than the minimum savings required by CAME. It is worth noting the almost non-existent non-performing loan portfolio. In 1995, a critical year for the Mexican economy, non-performing loans were just 2.6 percent of the total portfolio.

Table 5. CAME: Selected financial indicators.

Indicator	1993	1994	1995	1996	1997
Number of members	470	1,261	1,693	1,831	3,182
Loans per member (pesos)	305	452	643	811	1,162
Savings per member (pesos)	n.a.	301	416	571	769
Savings/loan per member (%)	n.a.	67	65	70	66
Non-Performing loans (%)	0.00	0.00	2.58	0.23	0.01

Source: CAME.

Compartamos is a microfinance NGO that has shown an excellent performance. As CAME, it employs a group-lending technology. The groups (*grupos solidarios)* are formed with an average of 31 women, mostly in rural areas. Each member of the group offers joint liability for the others.

The loans per member vary along a range of 400 to 5,000 pesos (US$47 to 580). Loans have to be paid over a period of 16 weeks, with weekly payments. A monthly interest rate of 5 percent (equivalent to a monthly real rate of 3.7 percent) is charged.

The outreach of *Compartamos* is impressive. Currently, it is working in some of the poorest areas of rural Mexico, such as Chiapas and Oaxaca. The number of members grew almost 85 percent in just three years, from 17,500 members in 1995 to 32,254 in 1997 (Table 6). So far, the growth of *Compartamos* has been matched by a good financial performance. The non-performing loan portfolio was just 2.6 percent in 1997, and the real return on assets went from -26 percent in 1995 to 10.2 percent in 1997.

Table 6. COMPARTAMOS: Selected financial indicators

Indicator	1995	1996	1997
Number of members	17,500	26,716	32,254
Number of groups	514	906	1,301
Loan per member (pesos)	239	362	481
Non-Performing loans (%)	0.4	1.2	2.6
Real annual return on assets (%)	-26.0	-18.8	10.2

Source: Compartamos.

The outreach success of *Compartamos* is in part linked to its food-work program. This program, which began in 1984, consists of a basket of food given to the head of the family in exchange for a number of hours of her/his work in the construction of public facilities. Most of the initial *grupos solidarios* were formed with the people already participating in the food-work program. The financial success of *Compartamos* is due to an outstanding management team whose goal is long-term sustainability.

The main funders of *Compartamos* are private organizations and individuals, as well as public institutions such as CGAP, IDB, and BANAMEX. If the growth trend of *Compartamos* continues, its managers are planning on becoming financially self-sufficient by the year 2006.

Some comments emerge from the analysis of *Emprendedores*, CAME, and *Compartamos*. First, the history of these NGOs shows that financial sustainability can be achieved without the intervention of apex organizations. Moreover, the IDB and the World Bank gave substantial loans to these NGOs only after they were along the road of becoming financially independent of their initial donors. Second, the three NGOs described here were the result of private initiatives. Neither the government nor other public institution had any influence on their creation. Third, creditworthiness as a criterion to grant loans is a major ingredient of their medium-term success.

IV. Second-Tier Financial Organizations

Financial apex organizations have a long history in Mexico. Some of the older promotion and guarantee funds were created in the 1940s and 1950s. The most outstanding are the set of funds related to agricultural activities (FIRA) and those created to promote exports of manufacturing firms (FOMEX), to finance investment in popular housing (FOVI), to encourage activities related to tourism (INFRATUR), and the Guarantee and Development Fund for Small and Medium Industry (FOGAIN). With the exception of FOGAIN, all of these funds were managed by the Central Bank (*Banco de México*). Among these funds, only FIRA and FOGAIN have indirectly reached the microenterprise sector. The analysis is restricted here to the second-tier financial organizations that have had some impact on the small and microenterprise sector.[7]

Rationale for creation of the apex organizations

According to the Mexican authorities, the rationale for the creation of financial apex organizations has rested on two arguments. The first one states that apex organizations avoid the perils of direct state intervention in (retailing) credit markets. The experience of the state-owned banks shows that very often the direct allocation of credit follows non-economic criteria. When this is the case, the rent-seeking efforts of pressure groups negatively influence what should be the purely technical decision of granting loans. In contrast, second-tier financial organizations could accept the technically-based decisions of commercial banks in the granting of loans if the banks keep enough of the credit risk (Maydon, 1994). If the banks take an important share of the credit risk, they will base their decisions on an strict evaluation of creditworthiness. This frequently does not happen when the state-owned banks engage in retail lending. Apex organizations are thus a good option for governments that are retreating from the retailing level.

According to these views, government-sponsored apex organizations can effectively induce private commercial banks to lend for productive activities considered to be of importance for economic development. This is the second rationale for the existence of financial apex organizations. Mexican experts argue that the role of the commercial banks is restricted to allocating funds discounted by the apex to the best borrowers within the target group. Even more, the private banks benefit from this role because, by diversifying their loan portfolio, they are able to reduce their

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[7] Numerous evaluations have assessed the performance of the Mexican *Fondos*. One of the earlier evaluations of FIRA discussed the determinants of the profitability for a private commercial bank of discounting loans with the apex organization (Gonzalez-Vega, 1975). Experimentation with rediscount rates and rediscounting ratios was being used to encourage private banks to fund a greater share of the portfolio with their own resources, with very limited success. This failure was attributed by the authorities to the "conservative attitude" of the banks. The paper demonstrated that the banks were simply choosing the most profitable of the options offered to them.

overall risk (Maydon, 1994). The apex mechanism can then be successfully used to encourage the downscaling of banks toward difficult clienteles.

Apex organizations have been extolled by government officials as efficient instruments to induce commercial banks into new areas of economic activity (Solis, 1970). These experts emphasize that rather than competing for borrowers with the commercial banks, as the state-owned banks do, the apex organizations are complementary of the private banks.

Government officials also argue that state intervention in credit markets is optimized through the operation of apex organizations. By discounting loans, the second-tier organizations have indirect access to the infrastructure of the commercial banking system. There is no need for the installation of branches or the support of large bureaucratic entities as in the case of the state-owned banks. Furthermore, the decisions to grant loans are taken by experienced private bank officials, who have the best available information about the potential borrowers (Maydon, 1994).

Mexican government officials have argued that effective state intervention in the allocation of credit was not possible during the previous stages of economic development. The initial phase of direct intervention allowed the commercial banks, however, to collect a better set of information on the manufacturing and agricultural sectors.

These officials also argue that state intervention in financial markets is still required for a number of reasons.[8] First, there are sectors of economic activity that the commercial banks regard as non-profitable. Microenterprises fit this category. Second, apex organizations are instruments to promote competition among commercial banks and to avoid "excessive" economic rents for the banks. This is accomplished through disbursements of the available resources to those commercial banks that offer the best conditions in terms of financial margin or market outreach (Maydon, 1994). Bidding for these funds contributes to the elimination of those rents.

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8 As indicated earlier, the paper reports on the arguments advanced by the authorities, as an important element in describing the evolution of the Mexican apex organizations, but the validity of these arguments is not evaluated here. It is interesting to note, however, that most of the arguments for apex organizations are made in comparison to the retailing state-owned banks, whose unsuccessful performance and the high social costs of their operations have been amply documented and recognized by the authorities. These experts fail to see, nevertheless, that the apex organizations suffer from many of the same shortcomings of organizational design as the state-owned banks.

Microfinance apex organizations in Mexico

The creation of employment has been the main criterion of outreach for the operation of the apex organizations that have served the small and microenterprise sector. To pursue this goal, these financial organizations have assisted enterprises characterized as being labor-intensive. Pursuit of this goal has led the apex organizations to incorporate not-so-large enterprises in their portfolios. Small and microenterprises, however, contribute significantly to employment. As an illustration of the relevance of the target sector in the demand for labor, in the 1988-1993 period, small firms (those with 1 to 100 workers) contributed to the creation of 59 percent of the total of new jobs, medium-size enterprises (101 to 300 workers) contributed with 16 percent, and large firms (more than 300 workers) contributed with 25 percent of total employment (Ruiz, 1995).

The revelation of the importance of the non-large enterprise sector led government officials during the 1991-94 period to enact the National Program for the Modernization and Development of Micro, Small, and Medium-Size Industrial Enterprises (*Programa para la Modernización y Desarrollo de la Industria Micro, Pequeña y Mediana*). The financial component of this plan confers NAFIN the protagonic role in the distribution of resources to non-large firms. The plan also encourages NAFIN to find new alternatives to respond to the financial demands of microenterprises.

NAFIN's clientele at the second-tier level is composed of commercial banks, credit unions, promotion entities (*entidades de fomento*), trust funds (*fideicomisos*), and leasing and factoring companies. Almost 90 percent of NAFIN's total discounting is made through commercial banks, while the share of credit unions and promotion entities is only 8 percent of the total. The remaining is distributed among the rest of these financial organizations.

A concise description of the major financial apex organizations that have reached the microenterprise sector follows.

FOGAIN

The Guarantee and Development Fund for Small and Medium Industry (FOGAIN) was created in 1953. This development fund was one of the first of its kind in Latin America, and its purpose was to assist the development of a labor-intensive industrial sector. Over the 20 years following its creation, however, the role of this fund was marginal. It was not until the president Echeverría (1970-1976) and López Portillo (1976-82) administrations that the role of FOGAIN was strengthened. From 1972 to 1976, for instance, in real pesos the amount of loans authorized rose by 19 percent and the number of loans rose by 72 percent (Ramírez, 1985).

Some available figures suggest that FOGAIN was reaching smaller firms during that period. The average size of loan in real terms decreased during the period from 257,000 to 177,000 pesos per firm. In addition, firms with less than 50 employees represented 81 percent of the total number of clients of FOGAIN (Ramírez, 1985).

NAFIN

With the recent restructuring of the development banking system, FOGAIN and other similar programs related to the development of non-large firms were appended to NAFIN. NAFIN's policy regarding the small and microenterprise sector has been unclear. The programs directed to this sector have been modified numerous times. Some of the relevant dimensions of these programs are the Micro and Small Enterprise Promotion Fund (*Programa de Apoyo a la Micro y Pequeña Empresa*) and the Microindustry Trust Fund. Currently, the attention of small and microenterprises is included in the main institutional program of NAFIN through its Second-Tier Operations Program (*Programa de Operaciones de Crédito de Segundo Piso*).[9] Table 7 reports on the definitions of enterprise classes by size.

Table 7. NAFIN: Definitions of micro, small, medium, and large enterprises

Enterprise size	By the number of employees	By annual total sales (thousands of dollars)[a]
Micro	Up to 15	Up to 180
Small	16 -- 100	181 -- 1,807
Medium	101 -- 250	1,808 -- 4,096
Large	250 or more	4,097 or more

a Given an exchange rate of 8.30 pesos per U.S. Dollar.
Source: NAFIN.

Savings and loan societies (SAPs) and credit cooperatives have requested that the financial authorities include them among NAFIN's clientele. This has not happened. On the one hand, the internal rules of NAFIN ban operations with non-formal organizations such as credit cooperatives. On the other hand, although the SAPs are formal financial organizations, they have been excluded because their loan activity is tied to the amount of savings collected among their members. External financing, in this case through NAFIN resources, could negatively affect the incentives that they have to increase the mobilization of internal savings.

In its apex functions, NAFIN has not been able to reach the microenterprise sector much. As Table 8 indicates, since 1990 the shares of the total disbursements of loans to small and micro-enterprises have decreased. A number of factors may explain this phenomenon. First, from 1982 to

9 The name of this program was changed recently. Its previous name was Single Financing Program for Industrial Modernization (*Programa Unico de Financiamiento a la Modernización Industrial* or PROMIN). The decision of the NAFIN authorities to rename FOMIN was taken as a signal that non-industrial activities can also be considered for the disbursements of funds. The NAFIN authorities have added that the new name of their main institutional program helps to emphasize the simultaneous existence of first-tier operations with its apex activities.

1989, the commercial banks were under the control of the government.[10] During this period, the allocation of the available loanable funds did not follow strict economic criteria. After 1989, the influence of government officials in the distribution of loans decreased substantially. The hypothesis is that the privatized banks have perceived the financing of microenterprises as a non-profitable or comparatively less profitable business.

A second factor that helps to explain the smaller participation of microenterprises in the total allocation of NAFIN credit is related to the lending technology of commercial banks. In effect, bank criteria to grant loans are based on the requirement of collateral and the analysis of financial statements. These requirements are fulfilled by a minimum number of microenterprises (NAFIN, 1997).

Table 8. NAFIN: Disbursement of credit by enterprise size, 1990-1997 (percentages and thousands of Pesos)

Year	Enterprise size				Total amount
	Micro	Small	Medium	Large	
1990	11.9	48.7	18.9	20.5	2,829,935
1991	15.5	57.6	8.1	18.8	12,232,175
1992	18.3	52.2	7.9	21.6	23,320,686
1993	19.9	55.4	6.1	18.7	34,879,642
1994	18.7	52.7	8.7	19.8	49,917,560
1995	7.0	15.8	12.5	64.8	10,433,517
1996	5.4	16.3	13.0	65.3	12,736,696
1997	5.9	22.5	15.7	55.9	6,319,739

Source: NAFIN.

V. New Microfinance Programs

The Global Microenterprise Development Program (PGDM)

The revelation of the potential of the microenterprise sector as an employer has led to the design of two new microfinance programs supported by the Government of Mexico and The World Bank. The first one is being designed by NAFIN officials. It is called the Global Microenterprise Development Program (*Programa Global para el Desarrollo de la Microempresa* or PGDM).

A pilot program will be implemented at the beginning of 1998, and it will include some non-government organizations operating in the central region of the country. Initially, NAFIN will

[10] In 1982, president López Portillo nationalized the domestic commercial banks. The banks were privatized in 1989.

operate at the first-tier level, but it is planned that later on NAFIN will limit its intervention just to that of a microfinance apex mechanism (see Box 1).

Box 1

Global Microenterprise Development Program (PGDM)

1. **Objective**

To promote and assist the development of microenterprises, so that they are able:

(a) to access the institutional entrepreneurial support system (*sistema institutional de respaldo empresarial),* and

(b) to participate in the formal sector of the economy based on their own competitiveness.

2. **Principles**

(a) Assistance-based criteria are rejected. Microenterprises should reach levels of efficiency and competitiveness similar to those of other foreign and domestic firms.

(b) The development of microenterprises requires non-financial support, such as organizational and technical assistance.

(c) The main problem of microenterprises is their self-sufficiency. Microenterprises can improve their performance by banding together. In this way, they will be able to reach both scope and scale economies.

3. **Structure and mechanics of operation**

Step 1. Entities of growth promotion (EGPs) are created by NAFIN. The EGPs are composed by NAFIN, microfinance NGOs, and state and municipal governments. NAFIN intervenes at the first-tier level. The EGP evaluates and authorizes the microenterprise's loan application, and NAFIN grants the loans directly to the microenterprise. The microfinance NGO collects payments on the loan on behalf of NAFIN. NAFIN places these payments in a reserve fund managed by the EGP (*Fondo de Contingencia y Desarrollo*).

Step 2. Same structure as in Step 1. The main difference is that NAFIN intervenes at the second-tier level. The microfinance NGO keeps an intermediation margin on the loan operations. NAFIN adds a share of the total loan payments to the reserve fund. This share is labeled as a contribution of the microenterprise sector.

The main objective of the PGDP is to "promote and support the development of micro-enterprises, so that they will be able to access the formal financial system" (NAFIN, 1997). This task is attempted in two steps. In the first step, several entities of growth promotion (*entidades de fomento*) will be created. These entities will be formed by microfinance NGOs, state and municipal governments, the microenterprise clientele, and NAFIN. Each one of these partners will contribute to the total initial capital.

At the beginning of the program, NAFIN will be the main source of funds for the loans disbursed to the borrowers selected by the microfinance NGO. The capital of the entities is supposed to increase *pari pasu* with repayments. For a certain period, not yet determined, all loan repayments will be added to the capital of the entities. The function of the entities, however, is not restricted to granting loans, but it also includes technical assistance provided by external advisors.

In the second step of the PGDM, NAFIN will restrict its participation to a second-tier function. In the most favorable scenario, it is expected that 30 entities of growth promotion will be operating around the country in the next three years. For this purpose, the elaboration of a comprehensive inventory of microfinance organizations is in progress. This inventory is supposed to help in the determination of the financial health of the participating microfinance organizations.

The PGDM is attractive because some of its elements are associated with the sustainability of this kind of a program. One of such elements is to respect both the selection of borrowers and the determination of the elements of the credit contracts by the microfinance organizations. This includes decisions on loan interest rates and on credit technologies. The program is not interventionist from this perspective.

Another important element in favor of the PGDM is expressed in its mission. In contrast with previous programs, the criterion for success of the program is related to the accessibility to credit for microenterprises and it is no longer related to the number of jobs generated or to the number of persons reached by the program.

Some potential problems are likely to emerge, however, in the operation of the program. One of such problems is related to the participation of the state and municipal governments. Prior experience indicates that political intervention is an element that can easily distort the purpose of any financial entity. Another potential problem is the sustainability of the program. NAFIN officials argue that their direct participation will end as soon as possible. The indirect role of NAFIN as a financial apex, in turn, will be determined on the basis of the financial health of the entities. If this commitment is believed by the NGOs, the greater will be the likelihood that the program will not end in a few years. Given past experiences in Mexico, however, the credibility of this threat will be hard to establish.

Rural Bank Branches Program

The second microfinance program in progress was designed by officials at the Ministry of Finance, the Central Bank, and The World Bank. In the initial stage, this program is providing a subsidy to commercial banks that set up branches in rural areas (Werner, 1997). The short-run objective of this program is to promote the opening of 200 branches in rural municipalities. Rural municipalities are defined as having less than 20,000 inhabitants. Although the program was supposed to start at the beginning of this year, a number of problems have delayed its implementation. One of the main problems is that the representatives of the commercial banks and government officials have disagreed with respect to the target municipalities.

A second stage of the RBBP will provide technical and informational assistance to the commercial banks involved in the program. The rationale for this stage rests on the assumption that private banks cannot "see that [rural banking] is a profitable business" (Werner, 1997, p. 10). For this purpose, officials at FOCIR (a trust fund that provides risk capital to rural firms) are developing a broad system of information on the profitability of a wide variety of agribusiness activities. FOCIR officials argue that this information will provide the banks with the main criteria to evaluate potential borrowers. The success of these efforts is yet to be seen.

VII. Lessons and Conclusions

Good intentions are not enough

Earlier, good intentions might have led government officials to intervene in credit markets. Numerous mechanisms to offer cheap credit were identified as potentially powerful instruments to promote investment in agriculture and manufacturing (Solis, 1971). Furthermore, cheap credit programs were attractive to policymakers for a number of reasons. Some of the reasons are that these programs are easy to implement and that they are always welcome by the potential beneficiaries.

That subsidized credit programs *appear* to generate results in a short period of time is another reason for the popularity of these interventions among policymakers. Usually, government officials are evaluated on a short-term basis, so they are likely to pursue policies that promise immediate results. In the long run they may be no longer in office.

State intervention in financial markets, however, has brought undesirable results. Even Mexican government officials recognize that rent-seeking and fraud plagues most of these credit programs. Even more, the sustainability of such programs is jeopardized always by high rate of non-performing loans.

Political factors are not absent in apex organizations

Apex organizations were supposed to ameliorate problems of rent-seeking and fraud because the selection of borrowers is made by private financial intermediaries. The experience of the Mexican apex organizations seems to contradict this view. Political factors have not been eliminated in the allocation of loanable funds through the apex organizations. In particular, the growth first and then debacle of the credit unions (*uniones de crédito*) illustrates the pernicious effects of political influence in financial matters.

Apex organizations are not well-suited to promote the microfinance sector

One argument in favor of apex organizations is that they can induce commercial banks into unknown markets, such as the microenterprise sector. The Mexican experience shows, however, that this is not necessarily the case. The bulk of the resources discounted by the apex organizations has been allocated to medium-size firms. This is explained by the criterion of outreach for most credit programs: employment. The new microfinance programs, in turn, are being designed to reach the microfinance sector. The future of these programs, however, will be determined by the commitment of the government to step down once the microfinance organizations reach a minimum degree of self-sufficiency.

No financial apex organization has been responsible for the growth of a dynamic microfinance sector in Mexico

A number of commercial banks and NGOs are making technological improvements to reach the microenterprise sector. They constitute the dynamic portion of this market niche. Neither the financial apex organizations nor the state-owned banks have been responsible for this phenomena. Several demand factors, such as the growth of the microenterprise sector and the requirements of immigrant Mexican workers to transfer funds, help explain much of this expansion. The most important initiatives in response to this expansion of the demand for services have come from the private sector and have had nothing to do with apex mechanisms. Government intervention may actually derail these important initiatives.

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